EXECUTIVE OFFICE OF THE PRESIDENT

COUNCIL OF ECONOMIC ADVISERS

WASHINGTON, D.C. 20500

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MEMORANDUM

To: Cabinet Council on Commerce and Trade

From: Council of Economic Advisers

Subject: Analysis of Suggestions to Aid the U.S. Auto Industry

Introduction

With sales of about 6.2 million cars, the domestic auto industry in 1981 went through its worst sales year in two decades. Unemployment in the industry stands at about 200,000 (indefinite layoffs), while related industry unemployment stood at 300,000 or more. These numbers do not include white collar layoffs.

Our current economic forecast does not hold out great hope for domestic auto sales in the immediate future. The forecast implies domestic sales of 6.5 to 7.0 million cars in 1982, about 7.5 million in 1983, and 8.0 to 8.5 million in 1984. In contrast, sales were 9.2 million in 1978 and 8.2 million in 1979. These forecasts are roughly consistent with other forecasts.

Four Policy Suggestions

This memorandum analyzes four types of suggestions to aid the industry:

(1) Regulatory relief proposals, with particular emphasis on the Clean Air Act;

(2) Reducing tariffs on auto parts and imposing at U.S. ports the same type of inspection procedures that U.S. autos face at Japanese ports;

(3) A 6 month personal tax credit of $1,500 for purchase of a U.S.-built car or truck meeting a minimum mileage standard of 25 m.p.g. (city); and

(4) A subsidy for scrapping old autos.

The proposals are examined in light of the following two criteria:

- Does the proposal provide near-term relief targeted at the domestic auto industry?
- Is the proposal likely to be effective and efficient?

Discussion of Possible Measures to Aid the Industry

1. Regulatory Relief

Two types of regulatory relief by the Federal Government would be possible. The first is to speed up the elimination of regulations affecting the automobile industry. Although it is possible to speed the reviews currently in progress, the impact on the auto industry is likely to be helpful but small.

More rapid reductions in regulations would provide earlier reductions in the capital costs of the automobile industry. In April 1981, 34 measures were proposed to reduce the regulatory burden on the automobile industry. Action had been taken by December 30, 1981, on 21 of these proposals, with an estimated savings in industry costs of $636 million over 5 years. Another 8 will be acted upon by March 31, 1982; they provide an additional cost savings of $594 million. The removal of the remaining 4 regulations would provide an estimated cost savings of $188 million over the next 5 years.

The second type of regulatory relief is to reduce regulations in other areas, such as the Clean Air standards. The identification of new regulations to be considered for elimination might produce a larger impact on the industry in the future, but it would not affect their immediate cash flow problems. Amendments to the Clean Air Act require Congressional action. The elimination of the fuel economy standard would have no immediate impact, since domestic fleets exceed the standard. Changes in the requirement that only cars with 75 percent of value added in the U.S. can be considered in the U.S. fleet would also have no impact on the next 6 months.

Beyond the original removal of 34 regulations are possible amendments to the Clean Air Act. The two proposals that would provide the most potential cost reduction to the automobile industry are the elimination of the requirement that all cars meet clean air standards in the most stringent (high altitude) areas and the relaxation of tailpipe emissions standards. Industry estimates of cost reductions for the entire set of

more lenient standards, including these two, range from $80 to $300 per car.

Although the net revenue effects of a cost decrease of $80 to $300 would be significant to the financial condition of the auto industry, they cannot be realized during this model year. The bills to amend the Clean Air Act are at a preliminary stage in Congress. The cost reductions are based on substantial changes in the fuel consumption/exhaust system components. The immediate impact of reducing the Clean Air Act requirements affecting the automobile industry would be negligible.

Another possibility is to remove the Fuel Economy Standards, which cost the auto industry an estimated $3.6 billion per one-mile per gallon increase in the standard. However, all domestic producers have announced that they plan to exceed the fuel economy standards during the 1980s for competitive reasons. Therefore, an elimination of the standard would not necessarily mean a reduction in costs nor in fuel efficiency.

A requirement in the fuel economy standards is that the standard must be met by the fleet that has 75 percent of its value added in the U.S. and Canada. This requirement prevents the averaging of highly fuel efficient foreign-produced cars with less efficient cars produced in North America, and thereby maintains higher cost, less efficient production in the United States. Although there are no estimates of the cost reductions to the automobile industry if the 75 percent value added requirement were reduced or eliminated, savings to the auto industry from this proposal would occur as plants were shut in the United States and production shifted abroad. It would provide little relief in the next 6 months.

2. Trade Suggestions

Two proposals have been suggested that would affect U.S. manufacturers' ability to compete with imported autos. The first is a reduction in the tariffs on imported automotive parts. Reductions in these tariffs have at most a small effect on the cost of domestically produced autos, and there would be a significant impact on the domestic parts manufacturing industry.

The average tariff on automobile parts imported into the U.S. is about 5 percent. Eliminating these tariffs would reduce the costs of imported parts to U.S. manufacturers. The

highest estimate of the total tariff costs on imported parts is $26.83 per vehicle. This reduction is small compared to either the tax credit or the regulatory relief actions. It would also have a significant negative impact on the domestic parts industry since an increasing proportion of parts in U.S. manufactured cars would be imported.

The second proposal is to adopt import certification procedures similar to those that the Japanese use to certify U.S. imports to Japan. The Japanese have two types of certification procedures, one for autos that are mass produced to Japanese standards, and another that combines a preliminary inspection of the car type with checks on each car by the local transport office. Adopting procedures that are similar to those used by the Japanese presents difficulties because:

- The Japanese mass produce for the U.S. market. The certification procedure placed on them is currently very similar to the one that could be applied on U.S. cars if U.S. manufacturers mass produced to Japanese specifications.

- U.S. certification procedures apply to all automobiles, both foreign and domestic. EPA requires that each model be certified, and each auto must bear a certification mark. NHTSA requires manufacturer self-certification. It is illegal under U.S. law to discriminate among cars in the certification process.

- In the United States there is no individual inspection of imported autos to determine compliance with certification requirements. Inspecting imported autos only from Japan would violate our policy of treating all imports on the same basis.

3. Temporary $1,500 Tax Credit for Auto Purchases

One proposal is a 6 month $1,500 personal tax credit for buying a U.S.-built vehicle achieving a minimum mileage

standard. Such a temporary subsidy, whatever its larger economic implications, would substantially affect the timing of sales as well as the magnitude. In particular, the tax credit would stimulate small car sales and hurt big car sales during the subsidy period -- and hurt small car sales and stimulate big car sales after the 6 month subsidy period.

Preliminary analysis by the Council of Economic Advisers indicates the following likely results:

- The proposal would increase new car sales by 150,000 during the rebate period. About 90,000 of these cars would have been bought anyway after the rebate period so that only 60,000 would be truly new sales.

- Auto manufacturers and dealers would gain approximately $900 million in added pretax net cash flow, and 12,000 man years of additional employment in the industry and its suppliers.

- The cost to the Treasury would be approximately $2.3 billion, or about $2.70 for every $1 of aid to the industry, about $40,000 per extra vehicle sale, and about $190,000 per extra work year of employment provided.

- The rebate proposal could be interpreted as a violation of GATT. This might induce the Japanese auto manufacturers to abandon their voluntary restraint program -- which was based upon their explicit understanding that we would refrain from any explicit protectionist measures.

4. Scrappage Subsidy

In terms of alleviating the current problems faced by the auto industry, a scrappage subsidy does not seem to offer significant benefits.

- The benefits of the subsidy would be diffused among domestic and foreign producers, and also among sellers of nonscrapped used cars.

- Because of the diffusion problems, the subsidy is not likely to be effective in terms of the industry's problems. The ratio of Treasury cost to industry benefit is likely to be high.

- A scrappage subsidy may be more effective and less costly in terms of reducing automotive emissions, at least over the near term, than tightening of emission standards for new cars.